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No. _____

In The

Supreme Court of the United States

JOSEPH AND ELIZABETH BARTON-DOBENIN,

Petitioners,

v.

KANSAS DEPARTMENT OF REVENUE,

Respondent.

On Petition For Writ Of Certiorari To The Kansas Supreme Court

PETITION FOR WRIT OF CERTIORARI

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QUESTIONS PRESENTED

Whether the dormant Foreign Commerce Clause applies to state income taxes imposed upon foreign business income earned by a resident individual who is an owner and manager of the foreign business and who engages in commercial activities between the United States and the Czech Republic.

If the answer to the above question is affirmative, whether Kan. Stat. Ann. § 79-32,111(a) (1989), which allowed Kansas resident individuals a credit for taxes paid to other states on income generated in interstate activities, but did not allow a credit for similar taxes paid to foreign countries, violated the nondiscrimination requirement of the dormant Foreign Commerce Clause.

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PETITION FOR WRIT OF CERTIORARI

Joseph and Elizabeth Barton-Dobenin respectfully petition for a writ of certiorari to review the judgment of the Supreme Court of the State of Kansas in this case.

OPINIONS BELOW

The opinion of the Kansas Supreme Court has been reported at 2000 WL 1005295 (Kan., 2000). The Court's opinion is reproduced in the Appendix at pages 1a-19a. The opinion of the Kansas Board of Tax Appeals is unreported. The Kansas Board's Order has been reproduced in the Appendix at pages 20a-27a. The Written Final Determination of the Kansas Department of Revenue is unreported. The Department's Written Final Determination has been reproduced in the Appendix at pages 40a-48a.

JURISDICTION

The Kansas Supreme Court entered its judgment on July 21, 2000. App. 2a. The jurisdiction of this Court is invoked under 28 U.S.C. § 1257(a).

CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

Article I, § 8, cl. 3, of the United States Constitution provides that Congress shall have Power "[t]o regulate Commerce with foreign nations, and among the several States, and with the Indian Tribes."

Article VI of the United States Constitution provides that "This Constitution . . . shall be the supreme Law of the Land."

Kan. Stat. Ann. § 79-32,111(a) (1989) provides:

> The amount of income tax paid to another state by a resident individual, resident estate or resident trust on income derived from sources in another state shall be allowed as a credit against the tax computed under the provisions of this act. Such credit shall not be greater in proportion to the tax computed under this act than the adjusted gross income for such year derived in another state while such taxpayer is a resident of this state is to the total Kansas adjusted gross income of the taxpayer.

STATEMENT

A. Relevant Facts

Petitioners are citizens of the United States and have been residents of the State of Kansas since 1958. In 1948, petitioner (Joseph Barton-Dobenin) fled the former Czechoslovakia and subsequently immigrated to the United States. In 1993, following the fall of the Iron Curtain and the democratization of the former Czechoslovakia, petitioner, along with his two brothers, successfully reclaimed title to the Dobenin family property, which had been confiscated by the Czechoslovakian Communist Party in 1948. App. 29a; R. I, Exhibit A, p. 30. It consists of substantial commercial real estate holdings in the cities of Prague and Nachod, including the

Zbraslav Center, along with 6,000 acres of farmland and timber in agricultural production. App. 29a, 39a.

Petitioner owns a one-third general partnership interest in the commercial activities and property located in Prague, including the Zbraslav Center and the farmland and timber. He owns a one-half general partnership interest in commercial property located in Nachod. App. 29a. The commercial activities in Prague include leasing space to over 200 businesses, which provide facilities for offices, retail stores, a restaurant, casino, and theatre. App. 39a. The Zbraslav center houses the Czech National Art Gallery and serves as a convention and meeting center. App. 39a.

Utilizing his PhD in Business Management, from 1995 forward, petitioner has been continuously engaged in managing the commercial operations and agricultural holdings conducted in the Czech Republic. Commercial activities performed by petitioner in Kansas consist of management review decisions and supervision of activities through regular communications with employees, agents, and business counterparts in the Czech Republic by phone, fax, and the mails. App. 30a; R. I, Exhibit A, p. 31. Petitioners travel regularly to the Czech Republic and stay extended periods of time during which petitioner likewise actively manages and participates in the various business interests. The Czech business operations result in the periodic transfer of Czech-source profits from the petitioners' bank in Prague to their bank in Manhattan, Kansas. App. 30a. For the time periods relevant herein, petitioner, along with his two brothers, who are also U.S. citizens, directly employed and managed 24 full-time

employees necessary for maintaining day-to-day operations of the business. R. V, Transcript of BOTA Hearing, Testimony of Joseph Barton-Dobenin, pp. 17-18. Petitioner and his two brothers also employed outside contractors to provide security services and to complete substantial capital improvements to the Prague complex necessary to modernize the structure and to repair it from the years of neglect while in the hands of the Czechoslovakian Communist Party. R. V, Transcript of BOTA Hearing, Testimony of Joseph Barton-Dobenin, pp. 19-22.

The petitioners timely filed federal and Kansas income tax returns for calendar year 1995. They paid $726,280 in 1995 income taxes to the Czech Republic. As part of their 1995 federal and Kansas adjusted gross income, the petitioners reported Czech-source income of $1,625,890. App. 30a. On their 1995 Kansas tax return they claimed a $104,028 credit under Kan. Stat. Ann. § 79-32,111(a) (1989) for taxes paid to the Czech Republic. App. 31a. The Kansas Department of Revenue disallowed the credit on the basis that the credit provided by Kan. Stat. Ann. § 79-32,111(a) (1989) did not apply to income taxes paid to foreign countries. App. 43a-45a. As illustrated by Stipulations No. 23 and 24, App. 33a, 34a, Kansas subjects extraterritorial business income earned in a foreign country to a greater tax than extraterritorial business income earned from identical activities conducted in other states within the United States. The petitioners' 1995 Kansas income tax (after disallowance of the credit) was $113,074. As stipulated by the parties, and by way of illustration, had petitioners' Czech Republic business been operated in Missouri, petitioners' 1995 Kansas income tax would have been $16,672.

B. Kansas Taxing Scheme

For resident individuals, the calculation of Kansas taxable income begins with the taxpayer's "federal adjusted income." Kan. Stat. Ann. § 79-32,117 (1997). Kan. Stat. Ann. § 79-32,117 (1997) provides for various modifications to federal adjusted income in arriving at Kansas adjusted income.

Kansas, like many other states, provides no apportionment and allocation scheme for multi-jurisdictional business income earned by resident individuals. For the time periods relevant herein, Kansas imposed income tax on 100% of all extraterritorial income earned by such individuals, whether earned directly as a sole proprietor, or indirectly through a "pass-through" entity such as an S corporation, limited liability company or partnership. However, Kansas provided tax relief for multi-jurisdictional business income by granting the subject credit for taxes paid to other U.S. states.[1] Thus, Kansas taxed 100% of a resident's foreign extraterritorial business income, but taxed less than 100% of most domestic extraterritorial business income.

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[1] Effective July 1, 1997, the Kansas Legislature amended Kan. Stat. Ann. § 79-32,111(a) (1989) to provide a credit for taxes paid to foreign countries through the incorporation by reference of the definition of the word "state" found in Kan. Stat. Ann. § 79-3271(h) (1997) which specifically defines the term to include foreign states and "political subdivisions thereof."

C. Similar State Taxing Schemes

Currently, 31 states provide a credit in some fashion for income taxes paid to other U.S. states with ostensibly no similar provision for taxes paid to foreign countries. Six states provide a credit for taxes paid to other U.S. states and for taxes paid to Canada, with no provision for taxes paid to other foreign countries. Six states provide a credit for taxes paid to U.S. states and similarly for taxes paid to any foreign country. For a more complete explication, see the Appendix at pp. 49a-51a.

D. Proceedings Below

Administrative procedure for Kansas income tax appeals requires two proceedings. First, an "Informal Conference" before the Secretary of Revenue (or Designate), Kan. Stat. Ann. § 79-3226(a) (1997), and second, a formal hearing before the Kansas Board of Tax Appeals. Kan. Stat. Ann. § 74-2438 (1992). Although the petitioners asserted that the credit provision was repugnant to the Commerce Clause of the United States Constitution at each of the administrative hearings, neither the Secretary of Revenue nor the Board had jurisdiction to entertain constitutional issues. App. 24a, 45a. Both of those proceedings upheld the disallowance of the credit by ruling on statutory construction issues that are not the subject of this Petition. The Board of Tax Appeals' Order was appealed to the Kansas Court of Appeals on grounds the Department's interpretation of Kan. Stat. Ann. § 79-32,111(a) (1989) violated the non-discrimination requirements of the dormant Foreign Commerce Clause of the U.S. Constitution. App. 10a.

On February 7, 2000, pursuant to its authority under Kan. Stat. Ann. § 20-3018(c) (1995), the Kansas Supreme Court removed the case from the Kansas Court of Appeals and subsequently heard and decided it on the merits. The petitioners' Foreign Commerce Clause challenge was first addressed by an adjudicative body in the Kansas Supreme Court opinion filed July 21, 2000. The court determined that the dormant Foreign Commerce Clause did not apply to the facts in this case, and therefore, did not address the petitioners' allegation of facial discrimination against foreign commerce. App. 18a.

Illustrative of the reasoning articulated and applied in its decision, the Kansas Supreme Court stated, in part, that "[t]he likelihood of the statute affecting foreign commerce is diminished by the universally accepted principal that a sovereign state retains power to tax its resident's income wherever earned." App. 13a. The court also found significant: "we do not deal with a direct tax upon income as in *Kraft*, but rather a credit given by Kansas to its residents paying state income taxes in other states," App. 11a; "the nature of the resulting tax in this case is an important consideration." App. 12a. Further, the court perceived the distinction between direct taxation of income from foreign commerce versus the denial of a credit for foreign taxes paid on that income as constitutionally relevant: "Significantly, the credit given to residents and the resulting tax is not a tax directly levied on foreign commerce." App. 14a. On this point, the court elaborated on its perception of the reach of the Foreign Commerce Clause:

> Under the facts of this case, the tax is not imposed upon the taxpayers' travels to the

> Czechoslovakian Republic, their telephone or mail communications, their consulting or managerial services, or on the transmission of money across international lines. Rather, the tax in question is a personal income tax imposed on a resident of the State of Kansas for the purpose of reimbursing the state for protections it affords the individual.
>
> App. 18a, 19a.

REASONS FOR GRANTING THE WRIT

This case presents an extremely important constitutional question: At what point must a state's sovereign power to tax a resident individual's income yield to the Commerce Clause?. As such, this issue goes to the very heart of the federalist system.

The lower court in Kansas implicitly carved out a de facto state sovereignty exception to the Commerce Clause. It refused to consider the petitioners' allegation of facial discrimination against foreign commerce on the apparent theory that the *nature* of the resident individual income tax places it beyond the reach of the Commerce Clause. In finding significant the fact that it was not a *direct* tax on foreign commerce, the lower court ignored this Court's clear instructions to look beyond the name and direct incidence of a challenged tax in order to assess its "practical effect" on commerce.[2] In so doing, it proceeded to revive the very formalisms long-rejected by this Court's modern Commerce Clause jurisprudence.

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[2] *See, Trinova Corporation v. Michigan Department of Treasury*, 498 U.S. 358, 372, 373 (1991) ("In Complete Auto, we renounced

In *Kraft Inc. v. Iowa Dept of Revenue*, 505 U.S. 71 (1992), this Court clarified that a state tax scheme which provided benefits to concerns engaged in domestic commerce, while denying the same to foreign commercial activities, was as equally repugnant to the Constitution as a tax that discriminatorily sought to encourage only local interests, to the detriment of those with interstate or foreign attributes. *Id.* at 79. This principle announced in *Kraft* has brought into question the application of a general scheme of state taxation under which foreign business income of individuals is taxed more heavily than domestic interstate income.

In the relatively short time since *Kraft*, two factors have heightened the significance of this conflict between state income tax laws and the Commerce Clause. The first is the burgeoning of a technology-driven "new" economy, which invites small business to go global.[3] The second is the increasingly prevalent use of U.S. federal income tax

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the formalistic approach of Spector Motor Service, Inc. v. O'Connor. . . . We seek to avoid formalism and to rely upon a 'consistent and rational method of inquiry [focusing on] the practical effect of a challenged tax.' ") (quoting *Mobil Oil Corp. v. Commissioner of Taxes of Vermont*, 445 U.S. 425, 443 (1980)). *See also, Camps Newfound/Owattona v. Town of Harrison et al.*, 520 U.S. 564, 580 (1997) (finding no difference in analysis between a tax that directly burdens interstate commerce or one that indirectly burdens the same where the discriminatory impact is eventually felt by interstate actors).

[3] This assertion is borne out in part by IRS statistics which provide that the use by individuals of the foreign tax credit (I.R.C. § 901) has increased by over 140.8% from 1991-1996. IRS, Statistics of Income Bulletin, Summer 1999, Publication 1136, p. 138 (9-99).

laws that provide for "pass-through" taxation of business income.

Business income of "pass-through" entities, such as S Corporations, limited liability companies, limited liability partnerships, limited partnerships and general partnerships is not taxed at the entity level, but rather is "passed through" the entity and taxed directly to the entity owners for federal income tax purposes.[4] In Kansas, as well as most other states (conforming to federal tax laws) the business taxable income of these entities is "passed through" and taxable personally to the owners for state income tax purposes.

Between 1985 and 1997, the number of taxable corporations filing tax returns has declined 11.5% (from 2,552,470 down to 2, 257,829). During the same period, the number of S Corporations has increased 238.4% (from 724,749 to 2,452,254). IRS, Statistics of Income Bulletin, Fall 1999, Publication 1136, p. 279, Table 13 (Rev. 11-99). Limited liability companies (LLC's), a recent addition to the choice of entity list, have experienced even more dramatic growth. For the two-year period from 1995-1997, the number of LLC's filing tax returns has increased 193.3% (from 119,000 to 349,000). IRS, Statistics

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[4] I.R.C. § 1363 (providing generally for the federal non-taxability of S Corporations at the entity level); I.R.C. § 701 (providing for the federal non-taxability of partnerships at the entity level).

of Income Bulletin, Fall 1999, Publication 1136, p. 53, Figure H (Rev. 11-99).[5]

In the past, constitutional concerns regarding multi-jurisdictional business income have focused on corporate income taxes, in part due to the practical reality that primarily only corporate entities took their business abroad. However, as illustrated above, the modern economy is increasingly driven by business entities that generate only personal taxable income rather than corporate taxable income. The stifling effect of discriminatory state taxation of individual foreign business income in today's economy has the same destructive potential as the discrimination once targeted at traditional corporations and decidedly rejected by this Court under earlier Commerce Clause jurisprudence.

Clarification by this Court is required to define the bounds of a state's resident income taxing power relative

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[5] The disfavor of taxable corporations and the increase in use of "pass-through" entities is largely a result of the Tax Reform Act of 1986, which: 1) repealed the so-called "General Utilities doctrine," and 2) reversed the historical differential between corporate and individual income tax rates. Prior to 1986, the codification of *General Utilities & Operating Co. v. Helvering*, 296 U.S. 200 (1935), provided only one level of taxation for liquidating sale or distribution of appreciated assets. After the 1986 Act, corporate liquidating sale or distribution of appreciated assets now involves taxation at both the corporate level *and* the shareholder level. *See*, I.R.C. § 311(b)(1). Prior to the 1986 Act, top marginal individual income tax rates were higher than top marginal corporate rates; the opposite occurred after the 1986 Act. *See*, BNA Tax Management Portfolios, Streng, 700-2nd T.M., *Choice of Entity*, Part I(B).

to the Commerce Clause. Review of this issue would additionally provide guidance to 37 states whose resident income tax schemes appear to discriminate against foreign commerce. This Court is presented with the opportunity to determine whether the same Commerce Clause standards will apply to all taxpayers, or whether commerce conducted by natural persons will be afforded less constitutional protection than is afforded to corporations, the latter being a result that would follow by implication if the lower decision remains undisturbed.

I. The Lower Court's Opinion Conflicts With The Decisions Of This Court As To The Scope Of The Commerce Clause's Applicability

A. The Lower Court Disregarded The Practical Inquiry Mandated By This Court And Applied Standards Which Are Contrary To Well-Established Law.

Decisions from this Court in recent years clearly indicate that discriminatory taxes on resident individuals generally will be subject to this Court's most rigorous Commerce Clause scrutiny. In *Fulton Corp v. Faulkner,* 516 U.S. 325 (1996), this Court invalidated a North Carolina intangibles tax that discriminatorily taxed residents on stock holdings. The discrimination in *Fulton* manifested itself through imposition of a tax calculated as an inverse function of the amount of business conducted by the issuing corporation in that state. The stock of corporations doing 100% of their business in North Carolina carried no tax liability for their resident owners, while stock of corporations with no taxable presence in the state carried the maximum tax liability. *Id.* at 328. This scheme

was invalidated, in part, due to its general effect of discouraging "domestic corporations from plying their trades in interstate commerce." *Id.* at 333. *Fulton Corp.* demonstrates a tax on residents need not impose a "direct" burden upon commerce in order to be invalid. Plainly, the intangibles tax was not directly levied on anything resembling interstate commerce, but rather, the *practical effect* of the tax was to indirectly discourage the conduct of interstate business activities of issuing corporations by creating a disincentive for residents to invest in corporations not predominately in North Carolina.

Recent decisions of this court also clarify that a purely local tax cannot escape Commerce Clause scrutiny if it has a potentially injurious effect on commerce. In *Camps Newfound/Owatonna v. Town of Harrison et al.*, 520 U.S. 564 (1997), the town of Harrison, Maine argued that a discriminatory real estate tax on property squarely situated in that state did not concern the Commerce Clause due to the local incidence of its tax. This Court found that where its imposition had either the potential effect of discouraging the conduct of an interstate business or of discouraging the interstate travel of those who would otherwise come to the camp (through passing-on additional costs to campers), Commerce Clause scrutiny was indeed necessary. *Id.* at 578.

The commonality of the underlying threat to interstate or foreign activities posed by the taxes in *Fulton*, in *Camps Newfound/Owatonna*, and in the instant case is obvious. If there were any distinguishing characteristics worthy of mention in the instant case, they would be that Kansas' discriminatory tax scheme directly distinguishes between foreign and domestic business income and

places a disincentive squarely upon those actually conducting foreign commerce.

All of this, however, escaped the lower court's apprehension. Instead, it identified the "threshold" standard to be that the petitioners must show by "clear and cogent" evidence that the tax reached "extraterritorial values."[6] App. 10a. The lower court's use of the "clear and cogent" standard from *Container Corp.* constitutes plain error and appears to be the result of a misunderstanding of dictum in this Court's dissenting opinion in *Kraft.*[7] In relying upon this threshold test, the lower court commingled and ultimately confused due process requirements not relevant in the instant case with concerns unique to the Commerce Clause.[8]

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[6] Citing *Container Corp. of America v. Franchise Tax Bd.*, 463 U.S. 159, 175 (1983) (where it was held that the invalidation of a non-discriminatory apportionment formula, as applied to a "unitary" business, depended upon the taxpayer clearly proving that the tax reached extraterritorial income to such a degree that notions of due process were offended).

[7] *See, Kraft, Inc. v. Iowa Dept. of Revenue*, 505 U.S. 71, 84 (1992) (Rehnquist, C.J., dissenting) (where the same language in *Container Corp.* was cited and the dissent noted that Kraft, Inc. failed to show decisively that its foreign subsidiaries actually engaged in foreign business activities).

[8] As this Court noted in *Trinova Corporation v. Michigan Department of Treasury*, 498 U.S. 358, 380 (1991), the standards under the Commerce Clause include the due process requirement that a tax scheme not attribute income to the state that is "out of all proportions to the business transacted . . . in that state." In the context of the application of formula apportionment to a "unitary" business as in *Container Corp.*, the successful challenge of a tax as violative of this due process aspect requires that a unitary taxpayer carry its burden under

Instead of assessing whether a higher tax burden on a taxpayer engaged in foreign commerce had an effect on that commerce, the lower court found that because the Kansas tax did not directly tax the methods by which foreign commerce was conducted, the tax did not substantially affect foreign commerce. App. 15a-17a. This finding is profoundly circular in its logic and ignores the fact that a tax credit, which is analytically indistinguishable from a government subsidy, most certainly has an effect on commerce. Whether accidental or intended, the practical effect of granting or denying an incentive for certain economic behavior, whether in the form of a subsidy or a tax credit, does not diminish when the recipient of the incentive happens to be a resident individual, instead of a corporation.

B. The Lower Court Decision Subordinated The Commerce Clause To A State's Sovereign Power To Tax.

The lower court's methodology is replete with reasoning indistinguishable from that which is appropriate only under exclusively due process inquiries. In excusing the discriminatory tax credit scheme in this manner, the lower court effectively contradicted the very principle that it recognized as governing:

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the "clear and cogent" rule. *Id.* Plainly, where the sole issue is that of discrimination in the context of a non-apportioned resident income tax, and where the constitutional complaint lies in the tax's threatening foreign commercial activities, questions of due process are not at issue. Neither *Container Corp.*, *Trinova Corp.*, nor the cases *Trinova Corp.* cites on this score indicate that this is an applicable "threshold" test.

> Clearly, the fact that resident income tax may be treated differently for due process purposes does not automatically absolve the tax from scrutiny under the Commerce Clause, for a tax may be consistent with due process but still violate the Foreign Commerce Clause. See *Quill Corp.*, 504 U.S. at 313 n.7. *Nonetheless*, the distinction demonstrates that the purpose of the income tax levy on residents is to provide services, benefits, and protections to that individual. While it is clear that a state income tax may, and in *Kraft*, did run afoul of the Foreign Commerce Clause, we think it significant that the credit given in this case and the state law concerned applies to a *resident* of the State of Kansas. *The likelihood of the statute affecting foreign commerce is diminished by the universally accepted principle that a sovereign state retains the power to tax its resident's income wherever earned.*

App. 13a. (Emphasis added).

The last sentence quoted above is tantamount to providing a blanket exemption from Commerce Clause scrutiny to state resident individual income taxes. Clearly, a "principle" cannot in reality increase or decrease the likelihood that a particular tax will actually affect foreign commerce. Therefore, the lower court's conclusion, along with its supporting recitation of strictly due process case law, creates a fictitious barrier insulating resident income taxes from the Commerce Clause, irrespective of the facts of any particular case.[9]

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[9] Along these lines, the lower court cited *Oklahoma Tax Comm'n v. Chickasaw Nation*, 505 U.S. 450, 463 (1995), *Maguire v. Trefry*, 253 U.S. 12, 14 (1920), and *N.Y. ex rel. Cohn v. Graves*, 300 U.S. 308, 312, 313 (1937)). App. 11a-13a.

The Supremacy Clause of the United States Constitution, on its face, mandates that no state taxing power preempts application of the dormant Foreign Commerce Clause where its scrutiny is otherwise applicable. This Court found in *Pennsylvania v. West Virginia*, 262 U.S. 553, 596 (1923) and restated in *Camps Newfound/Owatonna v. Town of Harrison et al.*, 520 U.S. 564, 574 (1997), that regardless of the power vested in a state to tax, "comprehensive and necessary as that power is," any state statute is susceptible to invalidation if it produces results prohibited under the Commerce Clause.

The lower court marginalized the activities of the petitioners and consequently denied the Commerce Clause its fullest application, subordinating it to the lower court's concern for state sovereignty. This leads to the conclusion that individual citizens can be denied constitutional protection afforded corporations based on due process considerations. The damage resulting from the lower court's decision is that it would deny the Commerce Clause its ability to address the "structural concerns about the effects of state regulation on the national economy." *Quill Corp. v. North Dakota*, 504 U.S. 298, 312 (1992).

C. Clarification of the Commerce Clause's Scope And Application To Individual Foreign Commerce Is Necessary

Safeguarding the "freest interchange" between the United States and foreign countries has been a recognized function of the Commerce Clause throughout this country's history. *Cook v. State of Pennsylvania*, 97 U.S. 566, 574

(1878). *See also, Hale v. Bimco*, 306 U.S. 375, 380, 381 (1939). In this case, the petitioners' decision to create a going concern out of their Czech properties gave rise to an economic connection between the U.S. and the Czech Republic that necessarily depends upon the conduct of activities historically seen as protected by the Commerce Clause.[10]

The lower court failed to recognize that the ability of the State of Kansas to tax, even obliquely, the petitioners' Czech business translates into the potential to directly discriminate against it and thereby threaten it and the activities necessary for its conduct. The institution of this type of economic protectionism most certainly works, "to the detriment of the nation as a whole." *Wardair Canada v. Florida Dept. of Revenue*, 477 U.S. 1, 8 (1986). The imposition of a higher Kansas tax on residents who do business in foreign countries constitutes a clear disincentive to engage in those business activities with foreign clients. Left unchecked, the possibility remains for even more egregious measures against foreign businesses.

The fact that the petitioners' activities in this case may not equal in scale commerce conducted by entities who have traditionally sought redress does not support the lower court's determination. This Court has made

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[10] *See, U.S. v. Underwriters Assoc.*, 322 U.S. 533, 541-543 (1944) (finding that the "transmission" of money, documents and communications across state lines constituted commerce). *See also, Kraft Inc. v. Iowa Dept. of Revenue*, 505 U.S. 71, 76 (1992) (recognizing that the "flow of value" represented by dividends paid from a foreign subsidiary to its domestic parent constituted commerce).

perfectly clear the same commercial attributes that trigger the empowerment of Congress to act under the Commerce Clause's affirmative grant likewise give rise to scrutiny under the dormant Commerce Clause. *Hughes v. Oklahoma*, 441 U.S. 322, 326 n.2 (1979) (citing *Philadelphia v. New Jersey*, 437 U.S. 617, 621-623 (1978)). As a necessary parallel to the scope of the Commerce Clause's affirmative grant of power, this Court has admonished against viewing the facts of any particular dormant Commerce Clause case "in isolation" in determining whether a "threat to the national economy" exists. *Camps Newfound/ Owatonna v. Town of Harrison et al.*, 520 U.S. 564, 586, 595 (1997). Therefore, the dormant Commerce Clause does not tolerate even the "smallest scale discrimination." *Id.* at 595.

II. Kan. Stat. Ann. § 79-32,111(a) (1989) Is The Practical Equivalent Of An Excise Tax On Residents For The Privilege Of Doing Business In Foreign Countries That Is Not Similarly Exacted From Residents For The Privilege Of Doing Business Among The U.S. States, And As Such, Discriminates Against Foreign Commerce.

Statutes that on their face provide for disparate treatment between domestic and foreign commerce are subjected to this Court's strictest scrutiny. *Kraft, Inc. v. Iowa Dept. of Revenue*, 505 U.S. 71, 81 (1992) (citing *Philadelphia v. New Jersey*, 437 U.S. 617, 626-628 (1978). "This is an extremely difficult burden, 'so heavy that facial discrimination by itself may be a fatal defect.' " *Camps Newfound /Owatonna*, 520 U.S. at 582 (quoting *Hughes*, 441 U.S. at 337). Therefore, state tax statutes that discriminate on

their face are, "virtually per se invalid." *Fulton Corp. v. Faulkner*, 516 U.S. 325, 331 (1996) (quoting *Oregon Waste Systems v. Environmental*, 511 U.S. 93, 99 (1994)).

Under the Kansas credit statute, the determinate for relief from income taxes paid to other jurisdictions rests *solely* upon the geographical source of the income. This geographic selectivity of the credit statute violates the most fundamental principle of this Court's Commerce Clause jurisprudence by taxing more harshly income which is derived from activities which fail to fall short of the water's edge.[11]

As presented to the lower court in oral arguments, if the State of Kansas were to enact a tax provision which specifically taxed the foreign-source income of its residents at a higher rate than resident domestic source income, it is doubtful anyone would view such a provision as satisfying Commerce Clause requirements. Kan. Stat. Ann. § 79-32,111(a) (1989) does just that, except that denying a credit is not as "forthright" as flatly imposing a higher tax rate. *Best & Co. v. Maxwell*, 311 U.S. 454, 455 (1940).

The Kansas Department of Revenue offered no justification for the statute's discriminatory elements. Instead, it argued that the credit statute does not discriminate against foreign commerce. The Department's reasoning is

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[11] As this Court notes in the interstate commerce context, "a state may not tax a transaction or incident more heavily when it crosses state lines than when it occurs entirely within the state." *Camps Newfound/Owatonna*, 520 U.S. at 581 (quoting *Chemical Waste Management Inc. v. Hunt*, 504 U.S. 334, 342 (1992)).

based upon comparing the petitioners to Kansas residents whose interstate activities transpire in selective states that impose no personal income tax. The Department's comparison also factors-in the application of U.S. federal tax laws. However, where facial discrimination is present, this is an improper comparison. As stated in *Kraft*, this court has specifically rejected the idea that state-level discrimination against foreign commerce can be excused based upon the leveling effect of other states' tax laws or the tax laws of the federal government. 505 U.S. at 80, 81.

The problems embodied in the instant case can only grow in scope in today's economy where the ability of individuals to engage in foreign commerce is expanding at an exponential rate. This, along with the blatant and geographically-based discrimination present on the face of the statute, militates for summary reversal of the lower decision and invalidation of the statute.

CONCLUSION

The promulgation of the challenged Kansas tax credit provision predates much of this Court's guidance as to the appropriate inquiry now mandated by modern Commerce Clause jurisprudence. The statute rests either on the archaic notion that resident individuals do not engage in activities implicating the dormant Foreign Commerce Clause or with complete indifference to the issue. The reluctance demonstrated by the lower court to recognize the clear lines between notions of due process and other distinct Commerce Clause concerns, along with its unwillingness to concede the broad application of many

of this Court's directives in other cases, has impliedly resulted in the de facto institution of a state sovereignty exception to the dormant Foreign Commerce Clause. The questions raised by the instant case must ultimately be answered. While the petitioners urge that the Commerce Clause requires vindication, even if this Court were to conclude otherwise, any reconciliation of the issues raised herein would provide guidance in the many other states where like provisions still govern and similar cases will surely follow.

Respectfully submitted,

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APPENDIX A

IN THE SUPREME COURT OF THE STATE OF KANSAS

No. 83,423

IN THE MATTER OF THE APPEAL OF JOSEPH & ELIZABETH BARTON-DOBENIN FROM AN ORDER OF THE DIVISION OF TAXATION ON ASSESSMENT OF INCOME TAX, PENALTY, AND INTEREST.

SYLLABUS BY THE COURT

1.

The constitutionality of a statute is presumed and all doubts must be resolved in favor of its validity; before the statute may be stricken down, it must clearly appear the statute violates the constitution. In determining the constitutionality of a statute, it is the court's duty to uphold the statue under attack rather than defeat it, and if there is any reasonable way to construe the statute as constitutionally valid, that should be done. Statutes are not stricken down unless the infringement of the superior law is clear beyond substantial doubt.

2.

The Commerce Clause of the United States Constitution represents not only an affirmative grant of power to Congress but also a negative command to the states that they may not, through the enactment of statutes or regulations, discriminate against or unduly burden interstate or foreign commerce.

3.

The threshold inquiry that must be made in a Foreign Commerce Clause analysis is whether the tax at issue

actually implicates foreign commerce. The taxpayer has the burden of showing by clear and cogent evidence that the state tax results in extraterritorial values being taxed.

4.

Under the facts of this case, the tax credit for state income taxes paid under K.S.A. 79-32,111(a) (Ensley 1989) is examined and it is held: The taxpayers have failed to establish by clear and cogent evidence that the tax at issue implicates the Foreign Commerce Clause, and, therefore, the credit is disallowed.

Appeal from the Kansas Board of Tax Appeals. Opinion filed July 21, 2000. Affirmed.

C. David Newbery, of Newbery & Ungerer, of Topeka, argued the cause and *Douglas C. Fincher*, of the same firm, was on the briefs for appellant.

James Bartle, general counsel, Kansas Department of Revenue, argued the cause, was on the brief for appellee.

The opinion of the court was delivered by

DAVIS, J.: Taxpayers Joseph and Elizabeth Barton-Dobenin appeal from an order issued by the Board of Tax Appeals (BOTA) denying them a Kansas individual income tax credit for the 1995 tax year for taxes paid to the Czechoslovakian Republic. The taxpayers argue that the Department of Revenue's interpretation of K.S.A. 79-32,111(a) (Ensley 1989) allowing a partial credit for taxes paid to other states but not for taxes paid to other nations, violated the Foreign Commerce Clause of the United States Constitution. U.S. Const. art I, § 8, cl. 3. For the reasons set forth, we affirm.

Taxpayers Joseph and Elizabeth Barton-Dobenin, husband and wife, are citizens of the United States and have been residents of the state of Kansas since 1958. Joseph Barton-Dobenin was born and raised in Czechoslovakia. He emigrated to the United States and in 1948, all of his family's property in Czechoslovakia was seized by the Communist regime.

Joseph, along with his brothers Cyrill and George, successfully reclaimed title to their family's property in 1993. The property consists of income-producing commercial real estate in the cities of Prague and Nachod, as well as 6,000 acres of farmland and timber. Joseph owns a one-third general partnership interest in the commercial property in Prague and in the farmland and timber, as well as a one-half general partnership interest in the commercial property in Nachod.

Joseph spent 15 weeks in Prague engaged in the management of his partnership interests in 1995 and spent the other 37 weeks of the year primarily in Kansas where he participated in the management of the partnership interests through activities such as telephone conversations, correspondence, management of personnel, and document review.

The income from Joseph's partnership interests is deposited in a Prague bank. According to testimony from Joseph, the majority of the income is reinvested in the various partnerships and some is also spent pursuing charitable interests in the Czechoslovakian Republic. Funds not expended or committed to charitable purposes in the Czechoslovakian Republic are periodically converted to United States dollars and transferred to the

bank account held by the taxpayers in Manhattan, Kansas.

The taxpayers filed a 1995 federal income tax return reporting Czechoslovakian source income in the amount of $1,625,890. On that income, the taxpayers paid the Czechoslovakian Republic income taxes in the amount of $726,280. The taxpayers' United States federal income tax return reported a federal income tax liability in the amount of $677,297. However, the taxpayers were granted a federal income tax credit in the amount of $615,028 for foreign taxes paid to the Czechoslovakian Republic. Thus, the taxpayers' total United States federal income tax liability on their Czechoslovakian source income was $62,269.

The taxpayers reported a total adjusted gross income of $1,776,731 in their 1995 Kansas income tax return which included the Czechoslovakian source income of $1,625,890. The total Kansas income tax due was $113,074. The taxpayers then attempted to claim a credit in the amount of $104,028 for taxes paid to the Czechoslovakian Republic under the authority of K.S.A. 79-32,111 (Ensley 1989), which at that time allowed a partial credit for the amount of income taxes paid by a resident individual to another state. This claimed credit would have reduced the total Kansas income tax liability to $9,046 and resulted in the taxpayers receiving a Kansas refund in the amount of $3,654 when previous payments of taxes were taken into account.

The Kansas Department of Revenue disallowed the tax credit, finding that foreign taxes were not taxes paid to another state under the statute. The Department of

Revenue assessed the taxpayers a balance due in the amount of $100,374 plus interest of $4,014.96. The taxpayers paid this amount under protest and appealed to the Department of Revenue's assessment. After an administrative hearing, the hearing officer denied the taxpayers' appeal. The taxpayers then appealed to BOTA.

Before BOTA, the taxpayers argued (1) that the word "state" in K.S.A. 79-32,111(a) (Ensley 1989) should be interpreted to include foreign nations; (2) in the alternative, the statute is ambiguous and should be interpreted to allow the credit; (3) if the statute does not include foreign nations, it violates the Equal Protection Clause of the Fourteenth Amendment to the United States Constitution; and (4) if the statute does not include foreign nations, it violates the Foreign Commerce Clause. The taxpayers stipulated that if the tax credit was allowed, it should be in the amount of $104,028.

BOTA held that the definition of "state" in K.S.A. 79-32,111(a) (Ensley 1989), did not include foreign nations. BOTA also held that it was without authority to address the taxpayers' Equal Protection Clause and Foreign Commerce Clause claims and affirmed the Department of Revenue's denial of the partial tax credit provided in K.S.A. 79-32,111(a) (Ensley 1989). The taxpayers appealed BOTA's decision to the Court of Appeals and the matter was transferred to this court pursuant to K.S.A. 20-3018(c).

Although the taxpayers raised several issues before BOTA, the sole issue raised in this appeal is whether the application of K.S.A. 79-32,111(a) (Ensley 1989) to the taxpayers violates the Foreign Commerce Clause of the

United States Constitution. The constitutional question raised is one of first impression in this state. It must also be noted that our decision, while significant to the taxpayers in this case, will have limited application. In 1997, the Kansas Legislature amended K.S.A. 79-32,111(a) to include foreign nations within the definition of the word "state," with the effect of allowing a limited tax credit for taxes paid to foreign nations. L. 1997, ch. 126, § 48.

Normally, the standard of review regarding appeals from BOTA is governed by the Kansas Act for Judicial Review and Civil Enforcement for Agency Actions, K.S.A. 77-601 *et seq.* However, the sole issue in this case involves the taxpayers' claim that K.S.A. 79-32,111(a) (Ensley 1989) is unconstitutional because it violates the Foreign Commerce Clause of the United States Constitution. BOTA did not have jurisdiction to address the constitutionality of the statute. See *Zarda v. State*, 250 Kan. 364, 370, 826 P.2d 1365 (1992) (stating that BOTA has no authority to determine the constitutionality of a statute and that the issue must be raised when the case is on appeal before a court of law). Thus, the merits of the question raised are to be addressed for the first time in this appeal.

Standard of Review

"The constitutionality of legislative enactments is presumed, and all doubts must be resolved in favor of a statute's validity." *State v. Wilkinson*, 269 Kan. ___, Syl. ¶ 1, ___ P.2d ___ (case No. 82,347, filed July 14, 2000). Recently, this court in *State ex rel. Tomasic v. Unified Gov. of Wyandotte Co./Kansas City*, 264 Kan. 293, 300, 955 P.2d 1136 (1998), clearly articulated the standard to be applied

when the constitutionality of a statute is challenged on appeal:

> "'"The constitutionality of a statute is presumed, all doubts must be resolved in favor of its validity, and before the statute may be stricken down, it must clearly appear the statute violates the constitution. [Citations omitted.]
>
> "'"In determining constitutionality, it is the court's duty to uphold a statute under attack rather than defeat it and if there is any reasonable way to construe the statute as constitutionally valid, that should be done. [Citations omitted.]
>
> "'"Statutes are not stricken down unless the infringement of the superior law is clear beyond substantial doubt. [Citations omitted.]"'"

Discussion

The statute in question, K.S.A. 79-32,111(a) (Ensley 1989), states:

> "The amount of income tax paid to another state by a resident individual, resident estate or resident trust on income derived from sources in another state shall be allowed as a credit against the tax computed under the provisions of this act. Such credit shall not be greater in proportion to the tax computed under this act than the adjusted gross income for such year derived in another state while such taxpayer is a resident of this state is to the total Kansas adjusted gross income of the taxpayer."

Thus, the statute provided a credit against Kansas income tax liability for taxes paid to another state. It did not,

however, provide a credit against tax liability for taxes paid to a foreign nation. The federal government, on the other hand, does provide a tax credit for taxes paid in foreign nations, whether the foreign nation characterizes such taxes as national, state, or local. See 26 U.S.C. § 901 (1994).

The Foreign Commerce Clause of the United States Constitution, like the Interstate Commerce Clause, comes from Art. I, § 8, cl. 3, which provides that "Congress shall have Power . . . to regulate Commerce with foreign Nations, and among the several States, and with the Indian Tribes." The Commerce Clause represents not only an affirmative grant of power to Congress but also a negative command to the states that they may not, through the enactment of statutes or regulations, discriminate against or unduly burden interstate or foreign commerce. See *Quill Corp. v. North Dakota*, 504 U.S. 298, 309, 119 L. Ed. 2d 91, 112 S. Ct. 1904 (1992). This negative command is sometimes referred to as the "dormant" Foreign Commerce Clause. 504 U.S. at 309. The power to strike down legislation conflicting with the Foreign Commerce Clause is the same as the power of Congress to legislate under the Foreign Commerce Clause. See *Hughes v. Oklahoma*, 441 U.S. 322, 326 n.2, 60 L. Ed. 2d 250, 99 S. Ct. 1727 (1979).

Where a State seeks to tax the instrumentalities of foreign commerce, the State tax must meet several requirements. First, the tax must pass the same test as that which is used to evaluate laws affecting interstate commerce. See *Japan Line, Ltd. v. County of Los Angeles*, 441 U.S. 434, 444-46, 60 L. Ed. 2d 336, 99 S. Ct. 1813 (1979). Under that test, the state tax must be: (1) applied

to an activity with a substantial nexus with the taxing state; (2) fairly apportioned; (3) not discriminatory towards interstate or foreign commerce; and (4) fairly related to the services provided by the State. *Japan Line*, 441 U.S. at 444-45. See *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274, 279, 51 L. Ed. 2d 326, 97 S. Ct. 1076 (1977) (establishing this test for interstate commerce). In addition, a tax on foreign commerce must not create a substantial risk of international multiple taxation by subjecting foreign commerce to the risk of a double tax burden to which domestic commerce is not exposed and must not prevent the federal government from "'speaking with one voice when regulating commercial relations with foreign governments.'" *Japan Line*, 441 U.S. at 451 (quoting *Michelin Tire Corp. v. Wages*, 423 U.S. 276, 285, 46 L. Ed. 2d 514, 96 S. Ct. 523 [1976]).

The Department of Revenue contends that the first four prongs of the analysis taken from *Complete Auto* do not apply to inquiries under the Foreign Commerce Clause. The Department argues that cases concerning the Foreign Commerce Clause after *Japan Line* do not discuss the *Complete Auto* test. In support of this contention, the Department cites *Kraft Gen. Foods, Inc. v. Iowa Dept. of Revenue and Finance*, 505 U.S. 71, 120 L. Ed. 2d 59, 112 S. Ct. 2365 (1992), and *Wardair Canada v. Florida Dept. of Revenue*, 477 U.S. 1, 91 L. Ed. 2d 1, 106 S. Ct. 2369 (1986). However, this assertion is patently incorrect.

It is true that the United States Supreme Court did not mention the *Complete Auto* test in *Kraft*. However, the only issue in *Kraft* was whether a business tax discriminated against foreign commerce, which is the third prong of the *Complete Auto* test. The other prongs of the *Complete*

Auto test, as well as the additional factors set forth in *Japan Line*, were waived as noted by the Iowa Supreme Court in the case below. See *Kraft v. Dept. of Revenue and Finance*, 465 N.W. 2d 664, 667 (Iowa 1991) (stating "Kraft does not ask us to apply [the entire *Complete Auto* and *Japan Line* test] which is specifically applicable to foreign commerce; rather, it confines its argument to the third prong of *Complete Auto Transit*, claiming that Iowa's tax system unconstitutionally discriminates against foreign commerce"). Further, in *Wardair*, the United States Supreme Court explicitly set out the *Complete Auto* test along with the additional factors in *Japan Line* and stated "appellant concedes that Florida's tax satisfies the four-part test set out in Complete Auto." 477 U.S. at 8. Clearly, the *Complete Auto* test must be satisfied in a case under the Foreign Commerce Clause, along with the two additional factors provided by *Japan Line*.

However, of those six factors, the taxpayers in this case explicitly state that they are arguing only about the third prong of the *Complete Auto* test which requires that a tax be nondiscriminatory toward foreign commerce. Therefore, the other three prongs of the *Complete Auto* test, as well as the two prongs introduced in *Japan Line*, can be counted as satisfied.

The threshold inquiry in a Foreign Commerce Clause analysis that must be made is whether the tax at issue actually implicates foreign commerce. See *United States v. Lopez*, 514 U.S. 549, 559, 131 L. Ed. 2d 626, 115 S. Ct. 1624 (1995). The taxpayer has the burden of showing by "clear and cogent evidence" that the state tax results in extraterritorial values being taxed. *Container Corp. v. Franchise Tax Bd.*, 463 U.S. 159, 175, 77 L. Ed. 2d 545, 103 S. Ct. 2933

(1983). Much has been written and numerous cases have been decided by the United States Supreme Court regarding the States' power to regulate matters affecting commerce. As noted by Justice Kennedy in his concurring opinion in *Lopez*:

> "[F]or almost a century after the adoption of the Constitution, the Court's Commerce Clause decisions did not concern the authority of Congress to legislate. Rather, the Court faced the related but quite distinct question of the authority of the States to regulate matters that would be within the commerce power had Congress chosen to act." 514 U.S. at 568-69.

However, very little guidance is given by the Court upon the application of the dormant Foreign Commerce Clause to the activity we now consider. It is important to recognize that we do not deal with a direct tax upon income as in *Kraft*, but rather a credit given by Kansas to its residents paying state income taxes in other states. Moreover, it is also important to recognize that the partial credit given by K.S.A. 79-32,111(a) (Ensley 1989) and the resulting Kansas tax is not a tax on the use of the channels of interstate or foreign commerce as in *Container Corp.*, nor is it a tax on the instrumentalities of foreign commerce, or persons or things in foreign commerce as in *Japan Lines* and *Container Corp.* Rather, the taxpayers' claim is that the tax is on activities having a substantial relation to foreign commerce. Further, the question is not presented to this court in the abstract, but it comes to us under very specific facts involving the application of a state income tax statute upon a resident of this state. See *Oklahoma Tax Comm'n. v. Chickasaw Nation*, 515 U.S. 450, 462-63, 132 L. Ed. 2d 400, 115 S. Ct. 2214 (1995).

The Department of Revenue argues that Foreign Commerce Clause scrutiny is inappropriate because the tax at issue is a personal income tax on a Kansas resident. We do not agree in every case that a personal income tax imposed by a sovereign on its residents escapes the Foreign Commerce Clause scrutiny. However, we do think that the nature of the resulting tax in this case is an important consideration.

The general principle that the receipt of income by a resident of the territory of a taxing sovereignty is a taxable event is universally recognized and has international acceptance. See *Oklahoma Tax Comm'n.*, 515 U.S. at 463. The credit given by K.S.A. 79-32,111(a) (Ensley 1989) arises from a personal income tax on a Kansas resident. Consistent with due process, a State may tax 100% of the income of its residents, even that income which is earned outside of the taxing jurisdiction. *Oklahoma Tax Comm'n.*, 515 U.S. at 462-63. This is in direct contrast to the income of nonresidents; generally, a State may not tax nonresidents on value earned outside its borders, although it may tax an apportioned share of a unitary business where the tax bears a rational relationship between the income attributed to the State and the intrastate values of the enterprise. See *ASARCO, Inc. v. Idaho State Tax Comm'n*, 458 U.S. 307, 315-16, 73 L. Ed. 2d 787, 102 S. Ct. 3103 (1982). The reason for this distinction between residents and nonresidents is that

> "income tax is founded upon the protection afforded to the recipient of the income by the government of the Commonwealth of his residence in his person, in his right to receive the income and in his enjoyment of the income

> when in his possession. That government provides for him all the advantages of living in safety and in freedom and of being protected by the law. It gives security to life, liberty and the other privileges of dwelling in a civilized community. It exacts in return a contribution to the support of that government measured by and based upon the income, in the fruition of which it defends him from unjust interference." *Maguire v. Trefry*, 253 U.S. 12, 14, 64 L. Ed. 739, 40 S. Ct. 417 (1920).

See *N.Y. ex rel. Cohn v. Graves*, 300 U.S. 308, 312-313, 81 L. Ed. 666, 57 S. Ct. 466 (1937).

Clearly, the fact that resident income tax may be treated differently for due process purposes does not automatically absolve the tax from scrutiny under the Foreign Commerce Clause, for a tax may be consistent with due process but still violate the Foreign Commerce Clause. See *Quill Corp.*, 504 U.S. at 313 n. 7. Nonetheless, the distinction demonstrates that the purpose of the income tax levy on residents is to provide services, benefits, and protections to that individual. While it is clear that a state income tax may, and in *Kraft* did, run afoul of the Foreign Commerce Clause, we think it significant that the credit given in this case and the state law concerned applies to a resident of the state of Kansas. The likelihood of the statute affecting foreign commerce is diminished by the universally accepted principle that a sovereign State retains power to tax its resident's income wherever earned.

The taxpayer has the burden of showing by clear and cogent evidence that the state tax at issue implicates foreign commerce. See *Container Corp. v. Franchise Tax Bd.*,

463 U.S. at 175. Authority under the Foreign Commerce Clause extends to three broad categories of activity: (1) the use of the channels of interstate or foreign commerce; (2) the instrumentalities of interstate or foreign commerce, or persons or things in interstate or foreign commerce; and (3) activities having a substantial relation to interstate or foreign commerce. *United States v. Lopez*, 514 U.S. at 558-59. The United States Supreme Court has defined commerce as follows:

> "'Commerce, undoubtedly, is traffic, but it is something more; it is intercourse. It describes the commercial intercourse between nations, and parts of nations, in all its branches, and is regulated by prescribing rules for carrying on that intercourse.'" *United States v. Lopez*, 514 U.S. at 553 (quoting the Court in *Gibbons v. Ogden*, 9 Wheat 1, 189-190, 6 L. Ed. 23 [1824]).

Significantly, the credit given to residents and the resulting tax is not a tax directly levied on foreign commerce. Rather, the credit given under conditions outlined in K.S.A. 79-32,111(a) (Ensley 1989) and the resulting tax is levied on a resident individual to pay for services that the resident receives from the State. The purpose of the Foreign Commerce Clause is to protect markets and participants in markets, not taxpayers as such. *General Motors Corp. v. Tracy*, 519 U.S. 278, 300, 136 L. Ed. 2d 761, 117 S. Ct. 811 (1997). It is not the purpose of the Foreign Commerce Clause to protect state residents from their own state taxes. *Goldberg v. Sweet*, 488 U.S. 252, 266, 102 L. Ed. 2d 607, 109 S. Ct. 582 (1989). In order for the Foreign Commerce Clause to be implicated, application of the statute must substantially affect foreign commerce. See *Lopez*, 514 U.S. at 559.

The taxpayers argue that the tax credit indirectly implicates foreign commerce, inasmuch as they are engaged in foreign commerce and the credit is denied on their income from this activity. However, their claim to foreign commerce is much more tenuous than that in other cases in which the Foreign Commerce Clause has been invoked. In *Japan Line*, the objects taxed, cargo containers, were clearly instrumentalities of foreign commerce. See 441 U.S. at 446. In *Kraft*, the corporation involved was a nonresident unitary business operating with wholly owned subsidiaries in domestic and foreign markets, rather than a state resident. See 505 U.S. at 75-77. Further, in Kraft, there was a stipulation between the parties that the activity involved constituted foreign commerce, and even with this stipulation, there was disagreement as to whether this was actually the case. See 505 U.S. at 85-86, Rehnquist, C.J., dissenting.

The taxpayers contend that Joseph "personally and routinely sets in motion a number of activities" with the Czechoslovakian Republic "which are indisputably protected by the Commerce Clause." First, the taxpayers argue that Joseph regularly traveled to the Czechoslovakian Republic on business and that this should be counted as commerce under *Camps Newfound/ Owatonna, Inc. v. Town of Harrison*, 520 U.S. 564, 137 L. Ed. 2d 852, 117 S. Ct. 1590 (1997), and *Hoke v. United States*, 227 U.S. 308, 57 L. Ed. 523, 33 S. Ct. 281 (1913). Neither of these cases directly support the taxpayers' assertion. In *Camps Newfound*, the tax imposed by Maine was a tax on real property which, through the use of a tax exemption, taxed summer camps whose primary clients were out-of-state campers more harshly than those who operated

primarily for in-state residents. The connection to commerce in that case was clear in that the camps were providers of goods and services for both in-state and interstate guests. See 520 U.S. at 572-73. *Hoke* involved a criminal statute regarding the transport of prostitutes across state lines. The nexus with interstate transportation in *Hoke* was well established. See 227 U.S. at 322-23. By contrast, the personal income tax imposed by Kansas upon the taxpayers does not tax Joseph's movement, nor is it a tax on his business for the services which it provides to interstate or foreign travelers.

The taxpayers argue that Joseph utilizes international telephone lines and mail in communicating with his partners and associates in the Czechoslovakian Republic, as well as transmitting money across international lines. The taxpayers contend that this also is commerce, citing *U.S. v. Underwriters Assn.*, 322 U.S. 533, 549, 88 L. Ed. 1440, 64 S. Ct. 1162 (1944). However, while *Underwriters* recognizes that such transmission is commerce which is subject to federal regulation; again, the credit given and the resulting tax under K.S.A. 79-32,111(a) (Ensley 1989) in this case are not levied on the transmissions of the taxpayer.

The taxpayers also contend that Joseph provides personal management services to his business in the Czechoslovakian Republic; thus, he is in fact a "service industry" under the *Camps Newfound* case. Further, the taxpayers contend that Joseph is a "conduit through which Czech Crowns become U.S. dollars and U.S. dollars become Czech Crowns." The taxpayer in *Camps Newfound* operated a summer camp on real estate in Maine serving youth across the nation. In this sense, it was

considered a service industry. The taxpayers in this case, however, provide management services to property Joseph owns in the Czechoslovakian Republic. The distinct differences between the taxpayer's claim to be a service industry and the facts supporting the claim of a service industry in *Camps Newfound* are apparent. Thus, the taxpayers' reliance upon *Camps Newfound* provides little support for the taxpayers' claim to be a service industry.

The taxpayers' reliance on *Kraft* to support their claim that Joseph is a conduit for exchange of Czechoslovakian Crowns for United States dollars and, thus, is engaged in foreign commerce, is also misplaced. In discussing the dormant Foreign Commerce Clause in *Kraft*, the United States Supreme Court noted that the flow of value between a parent company and its foreign subsidiaries constitutes foreign commerce. See 505 U.S. at 76. However, while the movement of income between domestic and foreign subsidiaries for the unitary business in *Kraft* was held to constitute foreign commerce, the movement and exchange of currency in this case is less so. According to the testimony, the majority of income earned in the Czechoslovakian Republic is reinvested in the various partnerships, while some is also spent pursuing charitable interests in the Czechoslovakian Republic. Funds not expended or committed are periodically converted to United States dollars and transferred to the bank account held by the taxpayers in Manhattan, Kansas. The activity here is nothing more than a withdrawal from a Czechoslovakian Republic bank and the deposit of those funds in a Kansas bank. Moreover, the tax in *Kraft* was a direct tax on the income of a nonresident foreign

corporation instead of a credit against tax to a local resident.

In *Tetreault v. Franchise Tax Bd.*, 255 Cal. App. 2d 277, 63 Cal. Rptr. 326 (1967), an attorney, in a firm which had offices in San Francisco and Tokyo, and his wife argued that they should be given a credit for partnership income on which he paid income tax to Japan. They argued that failure to give such a credit was a violation of his privilege to engage in foreign commerce. The court stated that "[t]he taxpayers are not engaged in 'foreign commerce' merely because they receive income from a foreign source" and found that the Foreign Commerce Clause was not violated. 255 Cal. App. 2d at 283-84.

The taxpayers in the case at hand have a slightly better claim to involvement in interstate commerce than the attorney in *Tetreault*. Here, rather than simply passively receiving partnership income, at least one of the taxpayers, Joseph, was actively involved in managing the foreign business. However, the personal banking transaction may hardly be classified as affecting foreign commerce.

We recognize that in certain circumstances, a state income tax can have a substantial effect on foreign commerce. However, we are not satisfied that the taxpayers have clearly established under the facts of this case that their claimed activity results in the implication of the Foreign Commerce Clause, *i.e.* that the tax involved affects activities having a substantial relation to interstate or foreign commerce. *United States v. Lopez*, 514 U.S. at 558-59. Under the facts of this case, the tax is not imposed

upon the taxpayers' travels to the Czechoslovakian Republic, their telephone or mail communications, their consulting or managerial services, or on the transmission of money across international lines. Rather, the tax in question is a personal income tax imposed on a resident of the state of Kansas for the purpose of reimbursing the state for protections it affords the individual.

A statute is not to be stricken down unless the infringement of the superior law is clear beyond substantial doubt. We hold that the taxpayers in this case have not met their burden to prove that the tax involved in this case is subject to the Foreign Commerce Clause.

Affirmed.

APPENDIX B

BEFORE THE BOARD OF TAX APPEALS
OF THE STATE OF KANSAS

IN THE MATTER OF THE APPEAL
OF DOBENIN, JOSEPH & ELIZABETH BARTON
FROM AN ORDER OF THE DIVISION OF
TAXATION ON ASSESSMENT OF
INCOME TAX PENALTY AND INTEREST.

Docket No. 1997-9971-DT

ORDER

Now, on this 29th day of April, 1999, the above-captioned matter comes on for consideration and decision by the Board of Tax Appeals of the State of Kansas.

This Board conducted a hearing in this matter on February 15, 1999. After considering all of the evidence presented thereat, and being fully advised in the premises, the Board finds and concludes as follows:

1. The Board has jurisdiction of the subject matter and of the parties, a proper and timely appeal having been filed, pursuant to K.S.A. 1998 Supp. 74-2438.

2. The Taxpayer appeared in person by Joseph Barton-Dobenin and by C. David Newbery, Attorney. The Kansas Department of Revenue (Department) appeared by James Bartle, Attorney.

3. The Taxpayer is a resident of the State of Kansas who owns property in the Czech Republic. As a result of successful business dealings with the property in the Czech Republic, the Taxpayer has realized a profit

and paid the appropriate income taxes to the Czech Republic. The Taxpayer requests that he be allowed to take a tax credit of $104,028, pursuant to K.S.A. 79-32,111(a) (1989), for the taxes paid to the Czech Republic. The 1995 tax year is the tax year at issue here.

4. The pertinent version of K.S.A. 79-32,111(a) (1989), which can be found in 1976 Kan. Sess. Laws, ch. 431, § 7, grants the Taxpayer a potential income tax credit as follows:

> The amount of income tax paid to another state by a resident individual, resident estate or resident trust on income derived from sources in another state shall be allowed as a credit against the tax computed under the provisions of this act. Such credit shall not be greater in proportion to the tax computed under this act than the adjusted gross income for such year derived in another state while such taxpayer is a resident of this state is to the total Kansas adjusted gross income of the taxpayer.

5. The issue before the Board is the definition of the word "state" as found in K.S.A. 79-32,111(a) (1989). The term "state" is not defined within the confines of K.S.A. 79-32,111 (1989).

6. The Taxpayer argues that "state" as defined in K.S.A. 79-3271(h) (1989) should be applied in the case. That statute is a part of the Uniform Division of Income for Tax Purposes Act (UDITPA). UDITPA was enacted for the income taxation of multi-

state and multi-national corporations. In that statute, foreign countries as well as the several states of the United States are included in the definition of "state."

7. In the alternative, the Taxpayer argues that the Department's interpretation of K.S.A. 79-32,111(a) (1989) violates the Commerce Clause and the Equal Protection Clause of the United States Constitution.

8. The Department has issued a regulation interpreting the statute. The regulation clearly defines "state" as "states, the District of Columbia, and territories of the United States." K.A.R. 92-12-11. The Board finds that *expressio unius est exclusio alterius* is appropriate in interpreting this regulation. In drafting the regulation, the Department could have included language to indicate that foreign countries should be included in the definition, but it did not.

9. "The Kansas Administrative Regulations, when adopted, have the force and effect of the statute. . . . " *Jones v. The Grain Club*, 227 Kan. 148, 150, 605 P.2d 142, (1980); *J.G. Masonry, Inc. v. Department of Revenue*, 235 Kan. 497, 500, 680 P.2d 291 (1984).

10. Therefore, the Board must interpret the regulation as if it were statutory law. The Board has no power to declare a statute invalid or to otherwise ignore a statute.

11. Although administrative regulations do not supersede statutory law, the Board finds that in this case, the regulation should be followed. See *In re Tax Appeal of Chief Industries, Inc.*, 255 Kan. 640, 650, 875 P.2d 278

(1994). The UDITPA statutes speak to specific situations and not the one before the Board. No evidence is presented to indicate that the Taxpayer falls within the purview of UDITPA. Instead, the regulation was promulgated specifically to interpret K.S.A. 79-32,111 (1989). The Board finds that the K.A.R. 92-12-11 is the appropriate avenue to look for the definition of the word "state" as found in K.S.A. 79-32,111(a) (1989).

12. The Taxpayer argues that K.S.A. 79-32,111(a) (1989) should be read *in pari materia* with K.S.A. 79-3271(h) (1989) so that a harmonious result is obtained. The Board finds that in this case it is better to interpret the statutes and regulations so that a general and tangentially related statute yields to a regulation, which has the force and effect of statue, [sic] which is specific. *American Fidelity Ins. Co. v. Employers Mut. Cas. Co.*, 3 Kan. App. 2d 245, 593 P.2d 14 (1979).

13. Even more telling is the 1997 amendment to K.S.A. 79-32,111(a). See 1997 Kan. Sess. Laws, ch. 126, § 48. The 1997 amendment states: "as used in this subsection, state shall have the meaning ascribed thereto by subsection (h) of K.S.A. 79-3271, and amendments thereto." K.S.A. 79-3271(h) has already been discussed in the Taxpayer's arguments. In other words, the Taxpayer is essentially requesting a retroactive application of the 1997 amendment to K.S.A. 79-32,111(a) (1989) for the 1995 tax year.

14. The Board finds that it is clear that prior to the amendment, the term "state" should be defined per the regulation. The amendment changed the statute to specify that "state" would be defined as set forth in K.S.A. 79-3271(h). The arguments do not persuade the Board that prior to the amendment, the statute should be defined by anything other than the regulation.

15. The Taxpayer raises numerous constitutional issues concerning the Equal Protection Clause and the Commerce Clause of the United States Constitution. The Board finds that it is without the power or the authority to invalidate any statute or regulation based on its interpretation of the United States Constitution. "It is the [board]'s duty to presume that the statutes are constitutional and valid." *Felten Truck Line v. State Board of Tax Appeals*, 183 Kan 287, 293, 327 P.2d 836 (1958). "Administrative boards and agencies may not rule on constitutional questions; therefore, the issue of the constitutionality of a state statute or an administrative regulation must be raised when the case is appealed to a court of law." *Kaufman v. Kansas Dept. of SRS*, 248 Kan. 951, 954, 811 P.2d 876 (1991).

16. Therefore, the Board finds that the Department's denial of the income tax credit to the Taxpayer should be affirmed.

IT IS THEREFORE ORDERED BY THE BOARD OF TAX APPEALS OF THE STATE OF KANSAS that the decision of the Department to deny the Taxpayer a credit

for taxes paid to the Czech Republic shall be, and is hereby, affirmed.

Any party to this appeal who is aggrieved by this decision may file a written petition for reconsideration with this Board as provided in K.S.A. 77-529, as amended by 1998 Kan. Sess. Laws, ch. 146, § 4. The written petition for reconsideration shall set forth specifically and in adequate detail the particular and specific respects in which it is alleged that the Board's order is unlawful, unreasonable, capricious, improper or unfair. Any petition for reconsideration shall be mailed to: Secretary, Board of Tax Appeals, DSOB Suite 451, 915 SW Harrison St., Topeka, KS 66612-1505. *A copy of the petition, together with all accompanying documents submitted, shall be mailed to all parties at the same time the petition is mailed to the Board. Failure to notify the opposing party shall render any subsequent order voidable.* The written petition must be received by the Board within fifteen (15) days of the certification date of this order (allowing an additional three days for mailing pursuant to statute if the Board serves the order by mail). If at 5:00 p.m. on the last day of the specified period the Board has not received a written petition for reconsideration, this order will become a final order from which no further appeal is available.

[SEAL]

IT IS SO ORDERED

/s/ Rita Maichel
RITA MAICHEL, SECRETARY

/s/ Carl Edwards
CARD EDWARDS, ATTORNEY

THE BOARD OF TAX APPEALS

/s/ August Bogina Jr.
AUGUST BOGINA, JR. P.E.,
CHAIRMAN

/s/ J. Lyn Entrikin Goering
J. LYN ENTRIKIN GOERING,
MEMBER

/s/ Robert G. Frey
ROBERT G. FREY, MEMBER

/s/ David L. Patton
DAVID L. PATTON, MEMBER

Recused
WAYNE C. VENNARD, JR.,
MEMBER

CERTIFICATION

I, Rita Maichel, Secretary of the Board of Tax Appeals of the State of Kansas, do hereby certify that a true and correct copy of the order in Docket No. 1997-9971-DT, and any attachments thereto, were placed in the United States Mail, on this 30th day of April, 1999, addressed to:

Joseph & Elizabeth
Barton-Dobenin
3181 Stagg Hill Rd
Manhattan, KS 66502-8134

C. David Newbery,
Attorney at Law
Newbery and Ungerer
2231 SW Wanamaker Rd
Ste 101
Topeka, KS 66614

and a copy was placed in capitol complex building mail, addressed to:

Division of Taxation
DSOB, 915 SW Harrison,
1st Floor
Topeka, KS 66612

James Bartle, Attorney
c/o General Counsel,
Dept. of Revenue
DSOB, 915 SW Harrison,
2nd Floor
Topeka, KS 66612

IN TESTIMONY WHEREOF, I have hereunto subscribed my name at Topeka, Kansas.

/s/ Rita Maichel
Rita Maichel, Secretary

APPENDIX C

BEFORE THE BOARD OF TAX APPEALS OF THE STATE OF KANSAS

IN THE MATTER OF THE APPEAL OF	)	
JOSEPH & ELIZABETH BARTON-DOBENIN	)	Docket No. 1997-9971-DT
FROM AN ORDER OF THE SECRETARY OF REVENUE ON AN ASSESSMENT OF INCOME TAX, PENALTY AND INTEREST.	)	

STIPULATED FACTS

COMES NOW Joseph and Elizabeth Barton-Dobenin ("Taxpayers") and the Kansas Department of Revenue ("Department"), by and through their respective counsel of record, and hereby stipulate and agree that the following facts shall be taken as true for purposes of this appeal. Nothing herein shall preclude either party from introducing additional facts and evidence not inconsistent with the facts herein stipulated. All exhibits attached hereto and referenced herein are hereby made a part of this stipulation.

Definitions. For purposes of this stipulation, the following words and terms shall have the following meanings:

a. "Department" shall mean the Kansas Department of Revenue.

b. "Secretary" shall mean the Secretary of the Kansas Department of Revenue.

c. "Czech" as used in conjunction with any term contained herein, shall mean the Czech Republic as it has existed since January 1, 1993.

d. "Czechoslovakia" shall mean the nation or Government of Czechoslovakia as it existed prior to January 1, 1993.

e. "Taxpayers" shall mean Joseph and/or Elizabeth Barton-Dobenin, married filing joint returns.

Stipulations. The parties hereby stipulate as follows:

1. Taxpayers are citizens of the United States and have been residents of the State of Kansas since 1958.

2. Joseph Barton-Dobenin is retired. He was formerly Professor of Business Management at Kansas State University. His personal history is set forth in an affidavit dated September 11, 1998, a copy of which is attached hereto and incorporated by reference as Exhibit A.

3. Joseph Barton-Dobenin was born and raised in Czechoslovakia. In 1948, all of his family's property in Czechoslovakia was seized by the Communist regime that was in power at the time.

4. In 1993, Joseph Barton-Dobenin and his brothers Cyrill and George Dobenin successfully reclaimed title to their family's property. The property in question consists of income-producing commercial real estate in the cities of Prague and Nachod and 6,000 acres of farm land and timber which is committed to agricultural production.

5. Joseph Barton-Dobenin owns a one-third general partnership interest in the commercial property located in Prague and in the farm land and timber. He owns a one-half general partnership interest in the commercial property located in Nachod.

6. In 1995, Joseph Barton-Dobenin spent 15 weeks in Prague where he was actively involved in the management of his general partnership interests. The other 37 weeks of the year were spent primarily in Kansas, where he participated in the management of his general partnership interests through activities such as telephone conversations, correspondence, document review, etc.

7. The income from Joseph Barton-Dobenin's general partnership interests is deposited in a Prague bank. Funds that are not expended or committed to charitable purposes in the Czech Republic are periodically converted to US dollars and transferred to the Taxpayers' bank account in Manhattan, Kansas.

8. The Taxpayers filed with the Internal Revenue Service a federal income tax return for tax year 1995 which reported Czech source income of $1,625,890. A copy of the Taxpayers' 1995 federal income tax return is attached hereto as Exhibit B.

9. The Taxpayers filed with the Government of the Czech Republic an income tax return for tax year 1995 and paid Czech income tax of $726,280. A copy of the Taxpayers' 1995 Czech Republic income tax return is attached as Exhibit C.

10. The Taxpayers' 1995 federal income tax return reported a federal income tax liability, before foreign tax credit, of $677,297. After claiming a credit of $615,028 for the foreign income taxes paid to the Czech Republic, the Taxpayers' remaining federal income tax liability was $62,269. The foreign tax credit of $615,028 represents a limitation amount rather than the actual tax paid to the Czech Republic; the limitation is the amount of U.S. federal income tax calculated on the foreign source income.

11. The Taxpayers timely filed with the Department a Kansas income tax return for tax year 1995 reporting Kansas adjusted gross income of $1,776,731, and such amount included 100% of the Taxpayers' Czech source income. This return claimed a credit of $104,028 for the income taxes paid to the Czech Republic. Under the law in effect at that time, the amount of income tax paid by a resident individual "to another state" was allowed as a credit for Kansas income tax purposes. [See K.S.A. 79-32,111 (Ensley 1989)]. A copy of the Taxpayers' 1995 Kansas income tax return is attached hereto as Exhibit D.

12. The Taxpayers' 1995 Kansas income tax return contains the following tax computations:

Line 12	Total Kansas tax	$ 113,074
Line 13	Credit for Czech income tax	(104,028)
Line 16	Balance	$ 9,046
Line 18	Estimated tax paid	$ (4,200)
Line 19	Amount paid with Kansas extension	(8,500)
Line 23	Overpayment	$ 3,654

13. By written notice dated August 22, 1996, the Department advised the Taxpayers that their 1995 Kansas income tax return had been adjusted. Specifically, the Department disallowed the credit of $104,028 claimed by the Taxpayers for income taxes paid to the Czech Republic. The notice stated, "Foreign Tax Credit not allowed as a credit for tax paid to other

state(s)." By this notice, the Department assessed the Taxpayers a balance due of $104,388.96, consisting of additional tax of $100,374 plus interest of $4,014.96. The notice implicitly denied the overpayment of $3,654 claimed on the Taxpayers' original return. A copy of the Department's assessment notice dated August 22, 1996 is attached hereto as Exhibit E.

14. On or about September 16, 1996, the Taxpayers paid under protest the Department's assessment of $104,388.96.

15. On October 18, 1996, the Taxpayers appealed the Department's assessment by filing a timely petition for hearing pursuant to K.S.A. 79-3226.

16. On July 1, 1997, an Informal Conference was held in reference to the Taxpayers' appeal by an administrative hearing officer designated by the Secretary of Revenue.

17. On November 21, 1997, the Secretary, through his designated administrative hearing officer, issued a Written Final Determination wherein the Taxpayers' appeal was denied and the Department's assessment was upheld in all respects.

18. On December 22, 1997, the Taxpayers appealed the Secretary's Written Final Determination by filing a timely Notice of Appeal with the Board of Tax Appeals.

19. For purposes of this appeal, the Taxpayers have caused to be prepared pro forma state income tax returns for Missouri and Kansas. Copies of these pro forma returns are attached hereto as Exhibit F (Missouri return) and Exhibit G (Kansas return).

20. If, in 1995, the general partnership properties owned by Joseph Barton-Dobenin had been located in Missouri rather than in the Czech Republic, and had

produced the same taxable net income of $1,625,890, the Taxpayers would have owed Missouri income tax of $96,402. [See Exhibit F, line 52].

21. Assuming the same facts as set forth in Paragraph 20 above, the Taxpayers would have been allowed to claim a credit of $96,402 on their 1995 Kansas income tax return for income taxes paid to Missouri, leaving $16,672 as the remaining balance of Kansas income tax due. [See Exhibit G, lines 13, 16].

22. There are Kansas resident individuals (other than the Taxpayers herein) who own and manage commercial real estate and/or farm land located in other states of the United States, including Missouri.

23. In summary, the Taxpayers' total income tax liability for tax year 1995, as determined by the Czech Republic, the Internal Revenue Service and the Department, was as follows:

Czech Republic income tax	$ 726,280
Federal income tax	62,269
Kansas income tax	113,074
Total tax – all jurisdictions	$ 901,623

24. In contrast, assuming the same facts as set forth in Paragraph 20 above, the Taxpayers' total income tax liability, as determined by the Internal Revenue

Service, the State of Missouri and the Department, would have been as follows:

Federal income tax	$ 677,297
Missouri income tax	96,402
Kansas income tax	16,672
Total tax – all jurisdictions	$ 790,371

25. K.S.A 79-32,111(a) places a limitation on the amount of credit allowed for taxes paid to other states. The maximum allowable credit is determined based on the ratio of income derived in other state(s) to total Kansas adjusted gross income. If the income tax of $726,280 paid by the Taxpayers to the Czech Republic in 1995 were to qualify for the credit for taxes paid to other states, the correct calculation of the allowable credit would be $104,028.

26. In 1997, K.S.A. 79-32,111(a) was amended to specifically include foreign countries within the definition of the word "state." [See 1997 Kan. Sess. Laws ch. 126, § 48]. If the 1997 amendment to K.S.A. 79-32,111(a) were applicable to tax year 1995, the correct calculation of the allowable credit for income taxes paid by the Taxpayers to the Czech Republic would be $104,028.

27. The parties agree that the total amount of tax in controversy is $104,028.

Submitted this 13th day of November, 1998, by:

/s/ C. David Newbery
C. David Newbery
Newbery & Ungerer

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ATTORNEY FOR THE
TAXPAYERS

/s/ James Bartle
James Bartle
Legal Services Bureau

Kansas Department of
Revenue
Docking State Office
Building
Topeka, KS 66612-1588
(785) 296-2381
ATTORNEY FOR THE
DEPARTMENT

APPENDIX D

BEFORE THE BOARD OF TAX APPEALS OF THE STATE OF KANSAS

IN THE MATTER OF THE APPEAL OF JOSEPH & ELIZABETH BARTON-DOBENIN FROM AN ORDER OF THE SECRETARY OF REVENUE ON AN ASSESSMENT OF INCOME TAX, PENALTY AND INTEREST.	)	Docket No. 1997-9971-DT

SUPPLEMENTAL STIPULATED FACTS

COMES NOW Joseph and Elizabeth Barton-Dobenin ("Taxpayers") and the Kansas Department of Revenue ("Department"), by and through their respective counsel of record, and hereby stipulate and agree that the following facts shall be taken as true for purposes of this appeal. Nothing herein shall preclude either party from introducing additional facts and evidence not inconsistent with the facts stipulated herein. All exhibits attached hereto and referenced herein are hereby made a part of this stipulation.

It is the intent of the parties that the stipulations set forth herein shall supplement those contained in the document entitled "Stipulated Facts" filed with the Board on November 13, 1998. Nothing herein shall be deemed to controvert any previously stipulated facts.

By approving these stipulations, neither party shall be deemed to have waived its right to object, on the grounds of relevancy or otherwise, to the admissibility of any stipulated fact as evidence in this appeal.

Definitions. The definitions contained in the document entitled "Stipulated Facts" filed with the Board on November 13, 1998 shall apply to the words and terms used herein.

Stipulations. The parties hereby stipulate as follows:

28. In a letter to the Director of taxation dated November 6, 1998, the Taxpayers filed a protective claim for refund of Kansas income tax and interest previously paid for tax year 1995. The Taxpayers claimed a refund of the following amounts:

Tax paid under protest	$100,374.00
Interest paid under protest	4,014.96
Overpayment credit denied	3,654.00
Total refund requested	$108,042.96

A copy of the Taxpayers' refund claim is attached hereto as Exhibit H.

29. In a letter to the Taxpayers dated November 19, 1998, the Department denied their refund claim. A copy of the Department's letter of denial is attached hereto as Exhibit I.

30. In a letter to the Department's Office of Administrative Appeals dated December 9, 1998, the Taxpayers requested an informal conference pursuant to K.S.A. 79-3226 to review the denial of their refund claim for tax year 1995. This appeal was assigned Docket No. 98-710.

31. In a letter to the Taxpayers' counsel dated January 6, 1999, the Department's administrative hearing officer agreed to hold Docket No. 98-710 in abeyance

pending the final resolution of BOTA Docket No. 1997-9971-DT. A copy of the hearing officer's letter is attached hereto as Exhibit J.

32. For purposes of this appeal, the Department made inquiry to determine the manner in which the Czech Republic taxes rental income received by a Czech resident from commercial properties located in the State of Kansas. A copy of the Department's letter to the Embassy of the Czech Republic dated October 26, 1998 is attached hereto as Exhibit K.

33. In a letter dated November 9, 1998, the Vice Consul of the Embassy of the Czech Republic responded to the Department's inquiry by stating that a Czech resident would be subject to Czech income tax on rental income received from Kansas sources. Further, Czech law does not allow a credit against the tax owed to the Czech Republic for any taxes paid to the State of Kansas. A copy of the letter from the Embassy of the Czech Republic is attached hereto as Exhibit L.

34. The letter from the Czech Embassy referred to in paragraph 33 above makes reference to an agreement between the Czech Republic and the United States on the prevention of double taxation. As stated in the letter, this agreement applies to federal income taxes, not state income taxes. The agreement in question is an Income Tax Treaty entitled "The Convention between the United States of America and the Czech Republic for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Income and Capital," which was signed in Prague on September 16, 1993 and entered into force on December 23, 1993. A copy of the Treaty, as set forth in the Report of the United States Senate wherein advise and consent was given to the ratification thereof, is attached hereto as Exhibit M.

35. The commercial property in Prague owned by Joseph Barton-Dobenin and his partners is occupied by approximately 220 tenants and consists of apartments, professional offices, retail shops, a theater, a casino and a restaurant. Pictures of this property are attached hereto as Exhibit N.

36. A portion of the rental income from the commercial property in Prague has been spent on historic restoration of the structure, electrical system improvements, heating system improvements and replacement of 1940's era elevators.

37. Joseph Barton-Dobenin and his partners also own and operate the Zbraslav Center, located approximately 7 miles outside of Prague, which houses the Czech National Art Gallery (donated to the government of the Czech Republic) and includes a convention and meeting center. Pictures of the Zbraslav Center are attached hereto as Exhibit O.

Submitted this 5th day of February, 1999, by:

/s/ C. David Newbery
C. David Newbery
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/s/ James Bartle
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ATTORNEY FOR THE DEPARTMENT

APPENDIX E

STATE OF KANSAS *DEPARTMENT OF REVENUE*
Bill Graves, Governor *John D. La Faver, Secretary*

[SEAL]

[Address And Phone Numbers Omitted In Printing]

Office of Administrative Appeals

November 21, 1997

C. David Newbery, Attorney at Law
Newbery & Ungerer
2231 S.W. Wanamaker
Topeka, Kansas 66614

Re: Written Final Determination in Request for Informal Conference for Reconsideration of Agency Action, Joseph and Elizabeth Dobenin, Docket Number 96-9848

Dear Mr. Newbery;

Your petition for a hearing before the Director of Taxation was timely filed with the Office of Administrative Appeals on October 18, 1996 and was assigned docket number 96-9848. You filed your request for hearing on behalf of your clients, Joseph and Elizabeth Dobenin, to seek reconsideration of the agency's August 22, 1996 notice of assessment of additional income tax.

Background

By its August 22, 1996 notice, the Kansas Department of Revenue advised your client that it was assessing additional income tax for tax year 1995 in the amount of $100,374, and accrued interest in the amount of $4,014.96

for a total of $104,388.96. Through your petition, taxpayers asserted that Kansas law allows the taxpayer to claim credits against Kansas individual income tax for taxes paid to "another state". K.S.A. 79-32,111. Taxpayer asserts that it should therefore be allowed to credit the amount it paid in income taxes to the Czech Republic in excess of its federal income tax liability against its Kansas income tax liability.

On July 1, 1997, this matter came before me, in my capacity as Designee of the Secretary of Revenue, for an informal conference in which you presented information and argument on behalf of the appellant. The Kansas Department of Revenue appeared and presented its arguments by counsel, Mr. Frank S. Reeb. Upon subsequent receipt of a transcript of the statutory informal conference, and in view that no further briefing of the legal issues in the matter was contemplated nor provided, this matter is fully submitted and ready for a determination.

Issues

The issues addressed during the statutory informal conference in this matter are whether under a statutory provision providing a credit against Kansas individual income tax liability for taxes paid to "another state", that term embraces taxes paid to other countries, and in the alternative, whether the provisions of the Uniform Division of Income for Tax Purposes Act are available to reduce taxpayer's income tax liability to this state.

Discussion and Analysis

An examination of the record in this matter reveals that the taxpayers herein, Joseph and Elizabeth Dobenin, filed their 1995 Kansas individual income tax return claiming as a credit against Kansas income tax an amount in taxes paid to the Czech Republic in excess of that amount of Czech Republic income taxes used as a credit against federal income tax liability. Mr. Dobenin, a U.S. citizen and Kansas resident, is a retired Kansas State University professor of business. In 1948, his family in Czechoslovakia lost all of their family holdings and property to the Communist regime. Tr., p. 3. At approximately that time, Mr. Dobenin came to this country where he received an education. He has lived here since that time. *Id.* In January of 1990, the Dobenin family properties were returned to Mr. Dobenin and his two brothers. *Id.* After several years, the Dobenins began to receive an income stream from the properties "in a form that was required to be reported for U.S. income tax". *Id.* Their income for 1995 "represents roughly three years of net income", and "is not a typical year in terms of the amount of dollars involved." *Id.* The Dobenin's 1995 federal income tax return reveals federal adjusted gross income of just over $1.8 million. The properties in question consist of a large commercial office building in downtown Prague covering an entire city block, a castle housing the Czech National Art Gallery, and "substantial" forests producing timber and rentals from hunting activities. Tr., p. 4. The three Dobenin brothers are general partners in the ownership of these properties. *Id.* A fourth property is owned one half by Mr. Dobenin in partnership with one of his brothers and is a smaller commercial property with

retail space, offices and apartments with a total of approximately 220 tenants. *Id.*, p. 4-5.

The Dobenins reported a total of $1,625,898 of net income from the Czech holdings on their 1995 federal income tax return. *Id.*, p. 6. Total Czech Republic income taxes paid in 1995 was $726,280. *Id.* Of this amount, the Dobenins claimed a credit against federal income tax liability of $615,828. *Id.* The ratio of Czech income to total income on the 1995 Kansas tax return was 92 percent. *Id.* Multiplying this percentage times their total Kansas income tax of $113,074 gives the Kansas income tax attributable to Czech income of $104,028. *Id.* The Czech Republic income tax rate and subsequent tax liability were higher than the federal tax rate and liability were higher than the federal tax rate and liability, and taxpayer asks that the amount paid in Czech income taxes in excess of the federal tax liability offset by the credit for Czech income taxes paid be used to offset the Kansas income tax imposed on the Czech income.

Taxpayer presents three alternative arguments in support of its request. First, K.S.A. 79-32,111(a) provides that "[t]he amount of income tax paid to another state by a resident individual . . . on income derived from sources in another state shall be allowed as a credit against the tax computed under the provisions of this act." Taxpayer urges that the tax it paid to the Czech Republic qualifies under the provision as "tax paid to another state". Taxpayer notes that the word "state" is defined at K.S.A. 79-3271(h), in the Uniform Division of Income for Tax Purposes Act, to include foreign countries and that nothing in an applicable regulation, K.A.R. 92-12-11, expressly excludes foreign countries from the definition of the term

"state". The department responds that the precise statutory wording that "tax paid to *another* state shall be allowed as a credit" indicates that only other states of this nation are implicated by the provision. The department also cites to the same administrative regulation, K.A.R. 92-12-11, for support of its position and to the 1992 decision of the Kansas Board of Tax Appeals in *In the Matter of the Appeal of Flusser,* Docket No. 92-11096-DT. The department also notes an amendment by the 1997 legislature in the statutory definition of "state" in K.S.A. 79-32,111 and reminds this tribunal of the strong presumption in Kansas law that "when the language of the statute is changed . . . the legislature intended to change the effect of the statute." Tr., p. 30.

The Secretary's Designee notes as a preliminary matter that the rules of construction applicable to claims for tax exemptions are likewise applicable to this claim of a credit against state income taxes. See *Flusser,* p. 2, 3. See also, *In re Tax Appeal of Collingwood Grain, Inc.,* 257 Kan. 237, 246 (1995)(holding that because both refund and exemption provisions serve the same purpose, they should be subject to the same strict rules of construction). In *Flusser,* the department disallowed a similar credit on a Kansas income tax return for income taxes paid to Canada. Reasoning that Kansas law limits the credit for income taxes paid to another state to the extent Kansas would have taxed the other state's income, the BOTA held that in order for the credit to be limited in a meaningful and consistent manner, the statutory provision contemplated that the credit for taxes paid to "another state" would be applicable only to those states within the parameters of the United States, and having in common

the concept of adjusted gross income as defined by federal law. *Flusser*, p. 5. Because this tribunal regards the decision of the Kansas Board of Tax Appeals in the *Flusser* case to be compelling, its reasoning is adopted in this matter as well. Other jurisdictions have reached similar results under similar statutory provisions. See JEROME R. HELLERSTEIN & WALTER HELLERSTEIN, STATE AND LOCAL TAXATION 914 (6th Ed. 1997)(noting that "[u]nder state statutory provisions providing a credit for taxes paid to other "states," the courts have held that the term does not embrace taxes paid to other countries", and citing to cases so holding). Taxpayer's first argument is rejected.

The taxpayer's second legal argument, although framed as being in part a public policy argument, is essentially that the application of the law in the manner presented by the present facts is unconstitutional, as violative perhaps of both the equal protection and foreign commerce clauses of the United States Constitution. Tr., p. 15. The taxpayer concedes that this is not the appropriate forum for arguments regarding constitutionality, *Id.*, and this functionary concurs. See, e.g., *Felten Truck Line v. State Board of Tax Appeals*, 183 Kan. 287, 293 (1958)("[t]he Commission [the predecessor to the Board of Tax Appeals] is not set up as a court to review the constitutionality of legislative enactments. It is an administrative body. It is the commission's duty to presume that the statutes are constitutional and valid."); *Zarda v. State*, 250 Kan. 364, 370 (1992)("'[s]ince administrative boards and agencies may not rule on constitutional questions, the issue of constitutionality must be raised when the case is on appeal before a court of law.'")(quoting *In re Residency*

Application of Bybee, 236 Kan. 443 (1984)). Taxpayer's second alternative argument must therefore await the consideration of a court of law for its resolution.

Taxpayer's third alternative argument is that the Uniform Division of Income for Tax Purposes Act should apply to the facts of this case. Taxpayer cites a provision of the act, codified at K.S.A. 79-3272, which states that "[a]ny taxpayer having income from business activity which is taxable both within and without this state . . . shall allocate and apportion net income as provided in this act." According to the taxpayer, the facts as outlined above support application of the act in determining taxpayer's tax liability to this state. The department counters, however, that the taxpayer here, as a resident individual, is not subject to that act, and further, that this taxpayer has no Kansas "business activity" within the meaning of the statutory provision. The Uniform Division of Income for Tax Purposes Act (hereinafter "U.D.I.T.P.A." or the "uniform act"), represents a method of apportioning a taxpayer's tax base by formula so as to assign that tax base to the various jurisdictions within which it operates. HELLERSTEIN & HELLERSTEIN, *supra* p. 410. Formulary apportionment is based on the theory that certain factors or elements of business activity will serve as a fair approximation of the income attributable to a state. *Id.* The apportionment formula most widely used by the states, and used for most business entities subject to Kansas corporate income taxation, is the so called Massachusetts, or three factor, formula. *Id.*; William J. Pierce, *The Uniform Division of Income for Tax Purposes*, vol. 35, no. 10 TAXES – THE TAX MAGAZINE 747, 750 (October,

1957). Apportionment by this method requires that the net income of a taxpayer be multiplied by the average of three factors, or elements of business activity. Each of the factors is a fraction representing the percentage of the taxpayer's real and tangible personal property, sales and payroll within the state compared to that entity's property, sales and payroll everywhere. HELLERSTEIN & HELLERSTEIN, *supra* p. 410; Kent L. Walgren, *Kennecott Copper Corporation v. State Tax Commission – The Relief Provision of the Uniform Division of Income for Tax Purposes Act*, Winter, 1972 UTAH L. REV. 607, 610.

In this instance, the taxpayer is a resident individual. It is well-established in the law that residence in a state provides a sufficient basis under the Due Process Clause to permit a state to tax all the resident's income from whatever source derived. HELLERSTEIN & HELLERSTEIN, *supra* p. 856. The department contends that in view that the state may tax all of a resident's extrajurisdictional income, had it been the legislature's intention to tax resident individuals through the U.D.I.T.P.A., that act would have clearly evidenced such a departure from established principles of law and from previous practice. Further, the department argues, since "modified Kansas source income" is defined at K.S.A. 79-32,109(h) as that part of a nonresident individual's income derived from business activity carried on within and without the state as determined by the provisions of the U.D.I.T.P.A., the legislature is clearly aware of the uniform act and intended for the act to apply only to nonresident, and not to resident, individuals. This tribunal finds the department's contentions to be persuasive. The view that the provisions of the uniform act are not applicable to this set of facts is further reinforced by the

fact that the taxpayer in the present instance has no business activity, that is, no property, payroll or sales, as defined by the uniform act, carried on within this state. Therefore, taxpayer's third alternative argument is likewise rejected.

Accordingly, upon reconsideration pursuant to K.S.A. 79-3610, as amended, I find that the decision appealed from in this matter is consistent with state law and the department's assessment of additional taxes in this matter is upheld.

This final determination constitutes final agency action subject to administrative review by the state board of tax appeals. If you wish to appeal this decision, you must file a notice of appeal, pursuant to K.S.A. 74-2438, with the secretary of the Board of Tax Appeals within thirty (30) days of this final determination and serve a copy of such notice upon the Secretary of Revenue or Secretary's Designee.

Very truly yours,
John D. LaFaver, Secretary
Kansas Department of Revenue
Docking State Office Building
Topeka, KS 66612
(913) 296-3041

By /s/ Douglas A. Hager
Douglas A. Hager, Director
Office of Administrative Appeals

MD
Certified Mail

cc: Frank S. Reeb, Legal Services

APPENDIX F

State Taxing Schemes

State credit provisions that allow, in some form, a credit for taxes paid to other U.S. States, but not to foreign countries:

Ala. Code § 40-18-21 (1991).

Ark. Code Ann. § 26-51-504 (Michie 1997).

Cal. Rev. & Tax. Code § 18001 (West 1994).

Colo. Rev. Stat. Ann. § 39-22-108 (West 2000).

Del. Code. Ann. tit. 30, § 1111 (1997).

D.C. Code Ann. § 47-1806.4(a) (1997).

Ga. Code Ann. § 48-7-28 (1995).

Idaho Code § 63-3029 (Michie 2000).

35 Ill. Comp. Stat. Ann. 5/601(3) (West 1996).

Ind. Code Ann. §§ 6-3-3-1, 6-3-3-3 (West 2000).

Ky. Rev. Stat. Ann. § 141.070 (Michie/Bobbs-Merrill 1991).

La. Rev. Stat. Ann. § 47:33 (West 1990 & Supp. 2000).

Me. Rev. Stat. Ann. tit. 36, § 5217-A (West 1990 & Supp. 1999).

Md. Code Ann., Tax-Gen. § 10-703 (1997).

Miss. Code Ann. § 27-7-77 (1999).

Mo. Ann. Stat. § 143.081 (West 1996 & Supp. 2000).

Neb. Rev. Stat. §§ 77-2715.07, 77-2730 (1996 & Supp. 1999).

N.J. Stat. Ann. § 54A:4-1 (West 1986 & Supp. 2000).

N.M. Stat. Ann. § 7-2-13 (Michie 1998).

N.D. Cent. Code § 57-38-04 (2000).

Ohio Rev. Code Ann. § 5747.05 (Anderson 1995).

Okla. Stat. Ann. tit. 68, § 2357 (West 1992 & Supp. 2000).

Or. Rev. Stat. § 316.082 (1993 & Supp. 1998).

72 Pa. Cons. Stat. Ann. § 7314 (West 2000).

R.I. Gen. Laws § 44-30-18 (1999).

S.C.Code Ann. § 12-6-3400 (Law. Co-op. 1977 & Supp. 1999).

Utah Code Ann. § 59-10-106 (1996).

Va. Code Ann. § 58.1-332 (1999).

W. Va. Code § 11-21-20 (1995).

Wis. Stat. Ann. § 71.07(7) (West 1999 & Supp. 2000).

State credit provisions that allow, in some form, a credit for taxes paid to other U.S. states and to Canada, but not to other foreign countries:

Conn. Gen. Stat. Ann. § 12-704 (West 1993 & Supp. 2000).

Mass. Ann. Laws. ch. 62, § 6(a) (Law. Co-op. 1991 & Supp. 2000).

Mich. Stat. Ann. § 7.557(1255) (Laws. Co-op. 1995 & Supp. 2000).

Minn. Stat. Ann. § 290.06(22) (West 1999 & Supp. 2000).

N.Y. Tax Law § 620 (McKinney 1999).

Vt. Stat. Ann. tit. 32, § 5825 (1994 & Supp. 1999).

State credit provisions that allow, in some form, a credit for taxes paid both to U.S. States and foreign countries:

Ariz. Rev. Stat. Ann. § 43-1071 (West 1998).

Haw. Rev. Stat. § 235-55 (1993 & Supp. 1999).

Iowa Code Ann. § 422.8 (West 1998).

Kan. Stat. Ann. § 79-32,111 (Supp. 1999).

Mont. Code Ann. § 15-30-124 (1999).

N.C. Gen. Stat. § 105-151 (1999).

Va. Code Ann. § 58.1-332.1 (1999) (Retirement Income Only).

States that tax only intangible personal income and do not allow a credit for taxes paid to U.S. States or foreign countries:

New Hampshire – N.H. Rev. Stat. Ann. §§ 77.3, 77.4 (1991 & Supp. 2000).

Tennessee – Tenn. Code Ann. § 67-2-102 (Michie 1998).

States with no personal income tax:

Alaska

Florida

Nevada

South Dakota

Texas

Washington

Wyoming